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on

I N S U R A N C E S T U D Y

TO

SUPERINTENDENT OF INSURANCE

MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

ONTARIO

Submitted by
Douglas H. Carruthers, Q.C.,
December 12, 1973

G. E. GRUNDY, F.C.A.
SUPERINTENDENT OF INSURANCE
REGISTRAR OF LOAN AND TRUST CORPORATIONS

6TH FLOOR, 555 YONGE ST.
TORONTO 284

ONTARIO
MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

To Douglas H. Carruthers, Q.C.

The Superintendent of Insurance for the Province of Ontario hereby appoints Douglas Henry Carruthers, Q.C., as special legal counsel to study, with specific regard to the public interest, the relations between insurers and those served or benefited by insurance, including, but not so as to restrict the generality of the foregoing, the services, responsibilities and organizations of insurance agents, insurance brokers, insurance adjusters, insurance consultants and risk management consultants, and, for this purpose, to solicit representations and submissions, and, when deemed advisable, to conduct hearings and receive testimony, either verbal or written or both, and in consequence to make recommendations to the Superintendent of Insurance for the Province of Ontario, as appears advisable, to the end that the Superintendent of Insurance may report thereon to the Minister of Consumer and Commercial Relations.

Dated at Toronto this 30th day of January, 1973.

G. E. Grundy

Superintendent of Insurance

R 15/7/75

TWO COMMENTS

"The Achilles heal of the industry is the cost of the agency distribution system which reflects high costs to the policy holder, the high cost of agency turnover of lapses and of policy switching"

Michael P. Walsh, C.L.U.
The Home Life Insurance Company

"The major problem in the life insurance market today is the lack of good, solid, reliable information at the point of sale concerning the benefits and prices of the insurance they are proposing to buy"

Joseph M. Belth, Ph.D., C.L.U.
University of Indiana

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1. INTRODUCTION

Here is a preliminary report of the study that you have asked me to undertake. Your instructions are reproduced at the front of this report.

My earliest inquiries led me to believe that each apparent problem had wide and complex ramifications with other problems. From the first, in my informal discussions with you, I have kept you informed of my unease about this problem. I told you of my feeling that a broad understanding of the industry was necessary for me to look at possible solutions to specific problems. Everything I have learned so far has turned this feeling into a conclusion. My present belief is that many of the apparent problems are simply evidence of stresses in the basic structure and operating practices of the industry. To attack the study from such a broad point of view has some major implications.

My effort has therefore been to pursue the study only far enough that I can draw out these implications clearly for you. I believe I have now gone far enough. I have now identified some important decisions you face before further cost should be incurred. In some respects this preliminary report is in the nature of a feasibility study, and by that I mean a study of whether further work is worthwhile. It is my recommendation that further study is worthwhile for reasons which will be dealt with later. At this point I would say if the study is pursued further, the main issues then are:

1) How broadly should the search for problems and solutions range?

2) How big a study will be required?

3) What form should further work on the study take?

2. SUMMARY OF RECOMMENDATIONS

The recommendations derived later in this report are:

1) the study of the industry should be continued because:

   - the present act and legislation are in need of substantial revision even to do well the job they appear to be intended to do;
   - it seems likely there would be substantial long run cost benefits to the consumer from more price competition in the marketing of life insurance
   - the consumer does not have the information he needs to make his purchasing decisions. The present system discourages the development of truly independent advisers who could help the consumer arrive at his decision.

2) the form of solution being sought should be one of opening the marketing structure to development in new directions, rather than recasting it in a predetermined model

3) the scope of the study should be broad and include questions of structure in the industry

4) the scale of the study should be major

5) the study should be organized so that value judgments from the community can be incorporated into the formulation of policy. The study should be conducted in a form that shows the paramountcy of the public interest.

3. OUTLINE OF WORK DONE

To assist me in this study I have had the part time assistance of:

- Mr. Blake Ford, a lawyer in your department. His knowledge of the operations and of the existing regulations and practices of your department has been of great help.
- Peter H. R. Alley. He is a Special Lecturer in the Faculty of Administrative Studies at York University and carries on his own business offering management assistance. He has assisted me to organize the study and assess my findings.

Here is what has been done to this point:

- Legislation affecting the insurance industry from all jurisdictions in Canada and many jurisdictions of the United States of America has been assembled and reviewed,
- information has been obtained about legislation in the United Kingdon, Australia, West Germany and France,
- a review has been made of reports of investigations inquiries or studies conducted in other jurisdictions, including the following:

The Hart Sub Committee,	United States Senate
Blue Ribbon Committee,	State of Pennsylvania
Consumer Council Report,	United Kingdon
N.A.I.C. Sub Committee Study,	, United States of America
Million Dollar Round Table Consumer Study,	United States of America

- a review has been made of studies on insurance marketing problems available from the Life Insurance Agency Management

Association, (LIAMA)

- informal discussions have been held with representatives and members of the major organizations active in the life industry including the Canadian Life Assurance Association and the Life Underwriters Association of Canada

- discussions have been held with three groups of people who might be equipped to assist with further studies including Faculty Members of two Schools of Business

- over fifty interviews have been held with knowledgable people connected with the life industry as buyers, sellers and insurers to help identify problems and gather information and views

- an informal review has been made with members of your department of the existing Ontario Legislation, regulation and practices

- an extensive collection of readings in books and articles has been made. This has been surveyed and some pieces studied in depth

It is to be noted at this point that this study is concentrating first on life insurance in accordance with your suggestions.

4.0 ANALYSIS

4.1 General Comments and a Summary

In order to say anything meaningful about the relations between insurers and insured, one has to have a sound understanding of the position of each party and the nature of the product or service passing from one to the other and the nature of the system by which the services are offered. Then one can start to consider in what ways it may be appropriate for government regulation to intervene on behalf of consumers, in 'the public interest'.

Since the government already has some involvement in controlling the relations between insurers and insured, it becomes necessary to look at the existing rules carefully. There are two steps to consider: what does one want to achieve, and what is the best way of doing it.

By analyzing the problem in this way a number of elements come into focus for study:

- the consumer and his needs
- the insurers, their role and the industry structure
- the services offered by insurers
- elements in the relations between them such as, pricing, selling and advertising and delivery of service
- how government regulation affects the relations
- the roles of identifiable groups operating in the areas of selling and delivery of service such as, agents, brokers, consultants

The purpose of the analysis was focused on recommendations on what improvements there might be in the role of the Superintendent in modifying the relations between the insurers and the insured.

For simplicity of presentation, the analysis is an affirmative statement. However, it is at this stage no more than an informed set of hypotheses. On the other hand in every case there is some evidence available, often indirect, to support the hypotheses.

In order that you have an understanding of how I have come to my conclusions I will show my analysis in the following sections:

- present regulation, practices and problems of the industry
- structure of the industry
- other related matters

Most, if not all, of this material will be familiar to you. A summary of the main conclusions from the analysis are set forth immediately below.

Present Regulation, Industry Practices and Problems

1) There is a need for immediate revision in certain respects

2) There is need for revision in the event it is required by conclusions derived from further study.

3) The problems are numerous

4) The problems are inter-related in some cases

5) The problems are not applicable to all companies or all classes of insurance

6) There are many proposed solutions, untried, untested and unaccepted, and

7) There are many proposed solutions that are inter-related

Industry Structure.

- The consumer has a complex and abstract decision to make for which he needs access to simple information;

- There are sophisticated participants in the life insurance buying decision who need fuller information;

- The industry is highly competitive,

  in the individual life insurance market competition is mainly on product differentation from different 'packages' and sales effort but not on price,

  in the group markets there appears to be price competition

- Prices are not clearly discernible to a buyer of life insurance and annuities, although it appears that helpful disclosure is possible;

- The selling function for individual life insurance is probably high cost and does not seem to provide for many economies of scale;

- Many problems surface in the selling system, but these appear to be the result of industry structure and pressures and traditional characteristics of the business and how it is organized;

Other related matters.

- The industry is already in direct competition with other major industries on some important services (individual investment, groups annuities and pensions, group accident and sickness insurance). Some companies seek opportunities in expanding this competition.

- The nature of regulation existing is not consistent between industries.

- The life insurance industry has not been a burning issue for consumerism in Canada, but it could become one if some of the problems were widely understood.

- The industry seems a bit defensive, and worried about the directions this enquiry might take. But on many important issues, the industry has no unified view.

- The industry has some powerful organizations ready to defend its interests. There is a strong interest in the status quo because it represents a balance in a zero sum game for market shares.

- Not much hard data on the industry in Ontario is readily available, but more could probably be obtained without too great cost because of the industry concentration

4.2. PRESENT REGULATION, INDUSTRY, PRACTICES and PROBLEMS

4.2.1. PRESENT STATUTES and REGULATIONS

A review of the existing Act and Regulations reveals difficulties, some of which can be dealt with forthwith, if desired, and some of which must be considered as part of a major revision and only altered accordingly.

I suggest to you that those provisions of the Act which relate to refusal to grant licence, revocation or suspension of licence, and hearings and appeals in connection therewith, be reviewed, and changed in any event regardless of what conclusions may or may not be derived from my study. The provisions relating to those things are scattered throughout the Act and the Regulations in a seemingly hit and miss fashion.

They start with Section 9, excluding the definition Section, then go through Sections 11, 32, 41, 42, 342, 359 and Section 14 of Regulation 539. You can recall asking me to comment to you in any event, on any matter or thing particularly if included in the Act which I thought called for attention regardless of the nature of my study. This is one of those things which in my respectful opinion requires immediate attention. The provisions are confusing, ambiguous and sometimes redundant and lacking. They offer a complicated system of proceeding. I think it would be best if I was to make my opinions and conclusions in this

connection the subject of a separate and more detailed report, except for my comments with respect to 342(6). I will prepare that report and provide it to you forthwith.

Insofar as the objects of the study are concerned other Sections of the Act require consideration and, as I have indicated above the extent of any changes to be made to those Sections will in the main be determined by any new policy decisions that may be arrived at as a result of conclusions derived from the study. I think firstly of the definition of "the agent" as contained in the Act. Certainly it is not adequate and probably should be broader but yet more concise. From my point of view it is not at all clear from reading the Act, based on the definition Sections, as to what persons who may be entitled to solicit insurance are not deemed to be agents within the meaning of the definition contained in the Act. The use of the word "compensation"in the definition is significant. But, by the same token, it probably is the source of the difficulty. Compensation in what form, paid by whom, at what time. This ambiguity alone prevents a clear application of the relevant Sections dealing with who, and who is not, entitled to solicit insurance in the Province of Ontario. There is a similar ambiguity concerning the definition of the term "broker". Of course

when we come to deal with the other than life aspects of the industry the confusion between agent, broker and salesman claims greater importance. As you realize the Act permits a licenced agent to be an agent or a broker but not a licenced broker whereas the Act prohibits a licenced broker from being a broker, agent or licenced agent.

Another Section which I find most confusing and is most relevant to the object of the study is Section 354. The marginal notes as contained in the Act suggest that that Section deals with persons acting as an agent, broker or adjuster without authority. The body of the Section is not that clear by any means. The Section in the first instance talks about a person who is not duly licenced as an agent, broker or adjuster, who "represents or holds himself out to the public as being <u>such</u> an agent, broker or adjuster ...". I have underlined the word "such" because obviously it refers to the words"duly licenced" in the first line. The Section then goes on to say "or as being engaged in the insurance business .... (by various means)". I don't know what the term "insurance business" means as referred to in that Section. Furthermore I don't know what that second provision of that Section applies to. The Section is intended to prevent a person holding himself out as an agent, broker or adjuster, licenced or not, and the section should say that clearly.

There was a recent amendment to Section 355 of the Act, the amendment being contained in Bill 208 and specifically Section 20 of that Bill. That amendment adds a sub-paragraph 2 which applies to all agents or brokers, whereas subsection 1 of the Section that now exists in the Act, by its own words excludes its application to agents or brokers in the life industry.

Subsection 2 of Section 1 of Regulation 539 appears to have been printed in an incorrect form. That subsection purports to relate to subsection 2 of Sections 4 and 5 of that Regulation. There is no subsection 2 of Section 5. It is suggested to me that the subsection should in fact refer to "subsection 2 of Section 4 and Section 5 ....". In any event, and of course, the Section can only be interpreted as it reads, the effect of either interpretation would appear to have the effect of excluding life agents from the provisions of Section 4, and from the provisions of Section 5. This I do not think is intended. The effect is to permit life agents to hold the various positions which are outlined in Subsection 2 of Section 4 of Regulation 539 without being in violation of that Regulation, and to permit life agents to carry on other businesses without being in violation of Section 5 of that Regulation. I understand it is the practice of the Department to apply those two provisions to agents whether life or other than life. A strict

reading of that Regulation or more correctly a strict application of that Regulation would not prevent a life agent in engaging in any other activity including the sale of mutual funds.

Section 342 imposes upon the Superintendent the duty to satisfy himself "that the applicant is a suitable person to receive a licence...". I have noted above the practice has been virtually to delegate this obligation to the company through the wording of the various forms that are filed in support of an application for licence. In fact, no other consideration is made by or on behalf of the Superintendent in connection with that duty other than the submission of the forms. I exclude of course the examination which is required by the Regulations. If that delegation is to remain then I submit that the Act should be amended to specifically allow for such delegation and at the same time to impose in clear terms standards which the industry must meet before it passes upon the suitability of a candidate and to allow for sanctions if it fails to do so.

I draw your attention to Section 342 (6), the effect of that section is to permit a company to virtually revoke a licence forthwith, without any hearing and with no right of appeal. That Section confirms my feeling that the issuance of a licence under the Act is based more on the sponsorship of a company than a person's entitlement, qualifications

I understand that Section 357, the Section dealing with twisting is under review and that certain regulations have been drafted and implement the present provisions of the Section. The only comment would be at this time that adequate disclosure to all interested parties would appear to be the answer to any problems; I gather disclosure is to be required under the new regulations. It is interesting to note that there is no requirement for such disclosure in the instance of the first policy being written up.

May I refer to Section 356, sub-paragraph 2. I realize it is the intention of that subsection to combat discrimination and to create stability. However, because it allows for no exceptions I have concern that it is being applied at times in a manner inconsistent with the overall intention of the sub-section, and at times, inconsistent with the rights of the consumer particularly in the group field. By this I mean that it is being applied at times in a way to force a larger premium to be paid by demanding the inclusion of a commission when the commission may not otherwise be requested by a broker or agent placing group insurance, either at all or at the level in fact paid.

The provisions of the Act which relate to single company sponsorship and single case exceptions, are honoured more in the breach in the group field. There does not appear to be any question that insofar as group

insurance is concerned, the practice is to shop around to place the cover with the company offering the best deal. Sections of the Act at times are used to prevent the best deal being granted because the sponsoring company simply refuses to grant a single case exception. In other occasions single case exception is granted to the discrimination of other insureds or the agents of the company who are unable themselves to get the same deal with their sponsoring company. In fact these provisions of the Act in my way of thinking support a "bad" practice which must be cleared up immediately. I am referring to the position of the so-called expert or consultant, licenced or not, who is advising the public with respect to group insurance plans, then shops around to get the best quotes and then by one means or another, if he is not licenced, either dealing with employees at head office, or agents with whom they have a working relationship, places the insurance. This situation gives rise to many problems in split commissions, special deals for special rates both premium wise and commission wise, addition of fees to commissions, improperly taking into account of commissions against fees and a whole host of other problems. The Act is deficient in not dealing with this situation although, any amendments or changes in this respect would be best made in light of an overall policy decision that may be reached in connection with the Act as a whole, there is room to make changes

although there are not that many unlicenced consultants, which must be covered by the Act as soon as possible.

I might at this time make reference to one other matter which causes me concern and which is similar to that which I have just mentioned above. There seems to be a practice amongst some members of the industry, both companies and agents, to promote the holding out of an agent or agents as being a consultant, an estate planning expert, financial advisor, etc. The letterhead for instance at the top will show only the name of the agent and the dissignation "consultant" or "expert". At the bottom of the letter, and I mean the very bottom and in very, very small print there is shown that he is licenced as an agent for a particular insurance company. In other words the desired effect appears to be the promotion of the fact that he is an independent consultant or expert, and the hiding of the fact that he is an insurance salesman. I think this practice should be reviewed in light of the deceptive practices.

4.2.2. PRACTICES AND PROBLEMS OF THE INDUSTRY

My study to this point has revealed a number of what I might call for the want of a better description, conditions, practices and requirements, some or all of which can also be classified as problems and all of which must be considered as part of an overview of the life industry for the purpose of determining

what if anything can be done, whether by way of legislation or otherwise, to better the position of the consumer in dealing with the life industry.

I doubt that there is anything new contained in the list hereinafter set out. I further doubt that there would be any surprise on the part of anyone in the life industry that any one of those conditions, practices or requirements could be considered a problem, particularly from the point of view of the consumer. In fact, there seems to be little difficulty in ascertaining the problems that have been with us for some time and are well recognized by the industry. There is much more difficulty in arriving at solutions of the problems.

The conditions, practices, requirements of which I have been talking, include the following, and I might point out that this list does not suggest any order of importance nor does it purport to be exhaustive, nor do they apply to all companies:

1. Inability of prospective purchasers of life insurance to compare the various forms of insurance contracts available to meet their means, and an inability to compare the costs of such insurance,due wholly or in part to several factors either alone or in combination, the factors being the lack of an adequate or proper means or method of price disclosure, a proliferation of contracts being offered in

the market and contracts are difficult to read and understand.

2. The inability of those engaged to sell life insurance, to advise prospective purchasers of what total range of products are available in the whole market due partly to the fact that a proper price comparison cannot be made and to a lack of knowledge of what total range of products are available. The persons engaged in selling life insurance are restricted to sell for one company and consequently are not aware of the price and costs and availability of various kinds of insurance through other companies.

3. A selling force which in the main is composed of poorly trained and educated individuals over 40% of whom will not remain in the industry for one year past the date upon which they are licenced.

4. Recruitment and training programs are orientated towards the interests of the company and the salesmen with little regard for the interests of the consumer.

5. The right of an agent to offer to the public for sale any and all kinds of products and services available through his company following the passing of a governmental examination that is based primarily on a "minimum level of product knowledge".

6. An industry which appears to create its greatest competition in the area of recruitment of salesmen rather than the satisfaction of the needs of the consumer.

7. An industry which accepts an inordinately high turnover of salesmen resulting in instability, high costs, waste of money, time and effort, and, in many instances, consumers who are left without service, then, described by the industry itself as "orphans".

8. Companies which appear to accept a low persistency record for the continuation of its products or in other words a high "lapse" rate particularly in the first year following sale.

9. The Industry apparently supports a field agency method of distribution to the exclusion of other direct methods that are available and satisfactory to meet certain needs of the consumers.

10. A system which supports and promotes a field agency method of distribution that is one company orientated with a method of payment to the agent by a commission based on a percentage of the price or costs of the insurance sold and which promotes the sale of a type of insurance which has the higher cost to the consumer.

11. A field agency method of distribution which has undisclosed sales costs and which promotes its sales

force to sell products with the higher premiums in spite of consumers' needs.

12. A field agency method of distribution which does not allow for free choice on the part of its sales force to distribute other forms of investment or insurance.

13. A field agency method of distribution which allows for very little if any post sale service.

14. A field agency method of distribution which allows for no compensation to the sales force unless a product is sold.

15. A field agency method of distribution which discourages the existence of a group of experts or consultants divorced from the interests of the company and who represents only the consumer.

16. A field agency method of distribution which includes contractual relationships between the company, its managers and salesmen, the object of which is to encapture the salesmen and the effect of which is to promote the interest of the company, manager or salesmen.

17. A field agency method of distribution which both promotes and discourages policy switching with the professed object being the interest of the consumer but with the real object being the interest of the company or the salesmen.

18. An industry which uses or applies names and descriptions in a manner not consistent with the usual or normal meaning ascribed to them in trade or in law such names being "agent", "broker", "premium", "policy", "dividend".

19. An industry which in many instances allows its sales force to hold itself out as independent experts, consultants or advisors disguising the fact that they are in fact salesmen representing one life insurance company.

20. A field agency method of distribution which promotes in some cases a payment of a commission when either no commission is desired or commission at a lower level will be accepted.

4.2.3. SOLUTIONS TO BE CONSIDERED

My study has indicated that a variety of solutions or remedies have been put forward by a variety of persons, institutions or associations interested in the life industry. Very few, if any of them have been either adopted into legislation or widely accepted. Some of these are:

1. Price disclosure.
2. Standardization of policies.
3. Multicompany representation.
4. Multi product licencing.
5. Step licencing.
6. Licences that restrict the type of product that can be sold by the holder.

7. System of brokers and independent consultants in the life industry.
8. The creation of a sales force, independent of the industry and self-trained, self-educated, self-supervised and paid by the consumer.
9. A government involvement in training: Approval of course material or creation of school and/or courses.
10. Upgrading information to be provided by the industry in annual statements to deal with lapse rates, agent retention, historical accuracy of projected dividends given at point of sale, reveal commission earnings of sales force.
11. Obtain information concerning lapse rate and production before licence is transferred or renewed.
12. Cost of acquisition of policy to be separate from premium and paid directly by the purchaser at beginning instead of being hidden in cash surrender value.

These various proposals are put forward for consideration only, not as recommendations at this time. Each of them has to be analyzed in terms of effectiveness, government involvement, industry acceptance and costs and inter-relationship to each other.

4.3 INDUSTRY STRUCTURE

4.3.1 The consumer and his needs

Elaborate descriptions can be written about the consumer and his needs. The following observations seem sufficient for present purposes:

- most people in Ontario are buyers from life insurance companies,
- the consumers need is abstract and complex; and he has alternatives
- the consumer has a personal choice about 'which?' 'whether?' and 'how much?' for which he requires some simple understandable information to make an optimal decision.
- in the purchase of group insurance there are others besides the life insured who are involved in the decision; they have need for more complex information about the service because of their more sophisticated ability.

Where decisions are complex and information is not clear decisions are made, but they tend to be made on simplifications (such as 'This salesman seems sincere'). Therefore the decision may be far from optimal.

4.3.2 The life Insurance Industry

Few industries have so many published statistics readily available. Nonetheless what is relevant to our purposes has not been easy to find. The following is a brief summary designed to put later remarks in perspective.

There are many (about 150) participants in the life insurance industry in Ontario, but the industry is dominated by a few. Five companies do half the business and the largest fifteen do 80%.

The industry appears to have saturated the market for its traditional services so that except for new growth from opportunities provided by changes in tax legislation, from population growth, and from changes in age distribution the market is relatively stable. Competition between companies in sale of traditional services is mainly for a larger slice of a fixed pie.

The total annual premiums paid to life insurance companies in 1972 was approximately $1,204 million. This is equal to almost one fifth of the annual expenditure budget of the Province and is about 3% of its gross national product.

A major economic function of the industry is as a financial intermediary - that is, as a conduit through which funds flow for investment. The industry annually invests almost as large a percentage of its receipts as it disburses in benefits - 37% of total receipts is invested compared with 44% paid out in benefits. The major services generating funds for investment are the sale of level premium life insurance to individuals and annuities - yielding about 85% of the investments by the industry. The magnitude of this role makes the management of investments a major function in a company.

The life insurance industry ranks second to banks in size as financial intermediaries. Over the long run the life insurance industry's relative importance in the economy as an intermediary, has been declining. The decline is mainly because a wider variety of investment alternatives is available to individuals now than formerly. Consistent with this trend the share of personal disposable income allocated to payment of life insurance premiums has shown a long term decline with ups and downs for wars, depressions

etc. These facts are further evidence of constraints on the growth of the life insurance market.

A criticism sometimes levelled at the life insurance industry is that its selling costs are high. It appears that for the industry as a whole, administrative, actuarial work and investment management cost about 14 % of the total annual premiums, while selling costs about 80 % of the new annual premiums. This counts the heavier administrative cost associated with starting a policy as part of administration. Selling costs for group insurance are reported to be much lower than for individual contracts. It is said that for individual life insurance contracts total new business costs sometimes exceed the first year premium. Such costs are high for a policy held less than ten years, as many are.

With the many life insurance companies in the industry, the business is very competitive. But, as will be discussed later, it is not competitive on price because price information is not available to the buyer in any meaningful way. Thus high selling costs are allowed to persist without much competitive price pressure.

Because for individual contracts selling costs are mostly directly variable with new sales, and a percentage commission is such a large part of the selling costs, therefore selling costs remain a relatively constant proportion of new business premiums. Therefore there are few economies of scale in selling, i.e. there is little reduction in selling costs per $1000 of premiums from selling more. For many of the 135

smaller isnurers the administrative, investment and actuarial costs are marginal costs because the main costs are incurred in the companies' home territories outside Canada. Thus, as long as they control their selling costs by not expanding rapidly and not seeking a larger share of the large company's business, they can be tolerated by their large competitors and they will be marginally profitable. If economies of scale were to become a significant factor in the selling of individual life insurance contracts, then many of these marginal foreign owned companies and the inefficient smaller Canadian owned companies would probably disappear from the scene.

4.3.3 Services offered

The services offered by the industry can be summarized as follows in terms of premiums paid.

Premiums paid in Ontario by Type of Contract in 1972
(in millions of dollars)

	Individual	Group	Total
Life insurance	480	172	652
Annuities or pensions	116	260	376
Accident and sickness	46 A	130A	176B
Total	642	562	1204
Percentage	53%	47%	100%

Notes: A. This allocation is estimated

B. An additional $46 million in premiums is paid to insurance companies not licensed to sell life insurance.

The following is evident from the above table:

1. Each of the services offered by life insurance companies is big enough to be important to them. Therefore any solutions sought must be suitable for each kind of business.

2. Individual life insurance is the biggest kind of service offered and accounts for about 40% of the business. Since it also gives rise to the greater part of the investments, what happens to it matters most to the industry.

3. Sales to groups, of all services, is almost as important as sales to individuals in total.

There is a bewildering array of sub-classifications of services and options and combinations. Varying rates of return on investment and probabilities of mortality etc., chosen, give rise to one set of variations, but for one class of contract one would expect these differences to simply show up as

differences in prices. But they do not. By varying the mixtures of class of contract and options, the price is obscured because the buyer can seldom compare apples with apples.

The contracts are usually written in obscure language. The current president of the Canadian Life Insurance Association explained recently that a life insurance policy is a legal contract and therefore cannot be expressed in clear language. While the conclusion is absurd, the remark tells much about the readability of insurance contracts and the industry's attitude toward the problem.

Hard to justify variations in policies and difficult to understand contracts are factors in preventing the consumer from having information in a form he needs.

4.3.4 Pricing

There are two aspects to the pricing question:

1) Are the companies making especially high mark-ups over their costs?

2) Are the prices of their services visible to the buyer so that he can allocate his resources after making a reasonable comparison with other alternatives?

On the first question there is no information available. There is a problem of allocating costs to services. There is also no reliable measure of aggregate corporate profitability in the industry. Until recently there has been no uniform method of accounting for profits in the conventional business sense. A research committee of the Canadian Institute of Chartered Accountants has recently published a suggested form of financial reporting that holds promise. But its recommendations have nct yet been adopted by the industry.

On the second question, price disclosure, it does not effectively exist in life insurance. The industry has contended that (a) there is no generally accepted way of measuring price and (b) where insurance and investment are mixed and time is a factor, an insurance contract is not susceptible to a standard measure of cost. However, the industry recently moved in Canada to offer a customer, if asked, a method which measures the cash flows taking account of the time value of money if a policy is held to maturity. Unfortunately this only allows comparison between two policies of the same amount and same type. It does not allow comparison with policies of different types nor with alternative investments where there is an investment element in the policy.

One writer has suggested there are twenty ways of comparing costs of insurance policies. Some are useless. But there are a few ways that can be taken seriously. Your own Actuary, Lear Wood, has developed two that hold great promise. The experts most advanced in this work apparently feel the need for ample discussion with each other before deciding on a 'best' method. Having reviewed some of the approaches, I am convinced it would be possible for a group of well selected experts to come up with a method that is much more useful than that proposed by the C.L.I.A.

It should be pointed out that the worst of the price disclosure problems appear to be in the individual life insurance area. Annuities are more easily compared; and for group business price competition is encouraged by more sophisticated buyers who are often assisted by brokers and actuarial consultants.

4.3.5 Delivery of services

Delivery of services encompasses a range of activities - prompt attention to applications, delivery of policy, answering requests for after-sale information, premium notices, collection and deposit of premiums, explanation of alternatives at decision points in the contract, and prompt settlement of claims under the contract.

Not many problems have come to my attention in this area. Apparently sometimes premiums in the hands of agents may not be handled as promptly and efficiently as desirable. No doubt there are other issues that might be raised in this area if a specific inquiry was organized, perhaps through a consumer group.

There is evidence that life insurance companies have done some effective work in controlling administrative costs by being early users of computers.

4.3.6 Selling

Selling is a function where a number of the problems seem to focus. Most of the problems seem to arise in the sale of individual contracts, not group. The problems can be understood against a background of the following factors:

pressures on the industry

- basically a zero-sum game of competition for a share of the market,
- growth likely to come from the sale of new products or services
- long run decline in proportion of business in the service (individual ordinary life) which yields the most funds for investment.

pressures on the salesman,

- remunerated increasingly on short term results i.e. sales made now
- some tendency for insurance companies to lower commission rates and a trend to sales of services that yield lower commissions (presumably in spite of an agent's temptation to push higher commission policies.)
- paid solely on commission
- salesmen often goes in debt to the insurance company in the training period

special characteristics of the business

- a complex abstract product
- highly competitive, but not on price
- price comparisons very difficult
- for sales to individuals selling costs are mainly variable

With the background outlined above it is possible to understand why the problems exist that were outlined earlier in the analysis of present practices and problems. One should note

that most of the problems are serious only for individual contracts. The problems together with this industry analysis suggest that it is the structure of the industry that is at the root of the problems.

Over 95% of individual life insurance and annuities contracts are sold through agents. Some companies in the industry make much of the legal arrangements which supposedly make these agents independent. In practical effect, however, at least those life insurance agents working in the branch system behave like employees. Their activities are really as controllable as those of any other employee who works away from his employers' office.

Group insurance is sold sometimes by agents, sometimes through brokers in or associated with the non-life business and sometimes directly by company employees specializing in group business or by some combination. Many are paid by the insurer, not the buyer.

There are about 12,000 individuals licensed to sell life insurance in the Province of Ontario of which approximately 8,000 may be fully active in the business at any one time. This works out to about one agent per 1,000 of the population or one per 200 or 300 families. Most of this sales force will be selling contracts to individuals. This is very concentrated and expensive distribution.

4.4 OTHER RELATED MATTERS

4.4.1 Competitive Industries and Regulation Standards Compared

Many of the services offered by insurance companies face competition from services offered by other classes of financial institutions. Often the competing services are not precisely the same legally, but they cater to the same consumer needs, and the legal distinctions are likely to be regarded as hair-splitting by the consumer. Here is a list of the products subject to close competition and the competitors:

Insurance company serivce	Competitor	Competitors service
life insurance policies with a cash surrender value (investment component)	Banks	(Savings accounts, (deposit receipts etc
	Trust companies	(Savings accounts, (debentures, (mortgage funds
	Investment funds	investment contracts
Accident and sickness individual and group	Non-life insurance companies	accident and sickness
Variable annuity funds	Mutual funds Trust companies	Units of funds invested in stocks or stocks and bonds
	Stock markets	Direct investments in shares
Group Annuity and Pension Funds	Trust companies Self administer-ed funds	Group annuity and pension funds
RRSP's except life insurance portion	Trust companies Mutual funds	R.R.S.P's
Income averaging annuity	Trust companies	Income averaging annuities

Several companies in the insurance industry are becoming increasingly active in direct competition with other classes of investment.

Regulations governing the offering of services in these competing industries vary widely. Price disclosure and interest rates and sales management charges where applicable are required to be disclosed for all but insurance companies' services. Special disclosure rules do apply for insurance companies' individual variable contracts and will apply soon where an individual life policy is being offered to replace another. Licensing of salesmen is required for securities mutual funds and insurance salesmen but licensed salesmen operate under different restrictions. For instance securities salesmen cannot make unsolicited sales calls, but a life insurance salesman can. The powers of the OSC and the SOI in licensing and enforcement differ. It would be reasonable to expect a measure of consistency at least within Ontario between regulations governing competing industries.

4.4.2 Consumerism and Insurance

Consumerism's impact on insurance is reflected in governmental activity in England and the United States as well as Canada. There are also articles on insurance problems in the general press from time to time here, and in specialized consumer publications and sensational expose paperbacks. It may be that an increasingly sophisticated public will become dissatisfied and that disclosure and consumer education will feed the fires of discontent by making the consumer more aware of problems in life insurance. Most popular material forcuses on price disclosure rather than the distribution system.

We are not aware of any organized consumer activity in Canada on insurance questions.

4.4.3 Organizations in Industry

The prospect of any change in regulation is likely to evoke some apprehension on the part of those regulated. It has already been observed in this case with public rumblings about ivory tower studies. One way to help alleviate such apprehension may be to allow ample opportunity for public input. This might be especially helpful if conclusions are likely to be contentious within the industry.

The industry is highly organized and can draw upon substantial resources. The Canadian Life Insurance Association which represents the companies and the Life Underwriters Association of Canada each has a staff equal in numbers to the Office of the Superintendent of Insurance. But the members of these groups do not always reach agreement on important questions.

4.4.4 Availability of industry data

On initial impressions one would conclude that there is a wealth of data available on life insurance companies.

There is material filed with the provincial and federal Superintendents of Insurance which provides selected information.

There are several industry associations gathering data. While these sources provide much data that is indicative, there is little available for many of the studies one might wish. What exists tends to suffer from one or more of the following deficiencies:

- inconsistent disclosure and classification from company to company
- segmented only by class of business (e.g. life, accident and sickness) rather than also grouped by company title
- segmented geographically by where the head office is situated, rather than where the business is sold, so Ontario data cannot be extracted
- available only from companies willing to participate in surveys so data may be biased and not representative
- data for Ontario is not available in sufficient detail

In some cases the needed data might be gathered without great cost, if there were an appropriate atmosphere of co-operation supported by authority sanctions. The concentration in the industry would allow significant savings in gathering data that had broad significance.

5. ALTERNATIVES AND RECOMMENDATIONS

5.1 Should the study proceed?

The key question is, should the study proceed? There are a number of considerations in favour of proceeding:

1) Present legislation is in need of some obvious revisions;

2) There are a number of proposals or practices from other jurisdictions which offer some promise for overcoming some of the weaknesses identified in the present system;

3) There is inadequate price competition in individual life insurance so the customer is bearing the high sales cost of a distribution system that offers few economies of scale. Changes encouraging competition might lead to lower cost.

4) The consumer gets inadequate disclosure for an important and complicated investment offerings. He does not get the information he needs to decide.

There are some disadvantages:

1) The cost of the required study might be high and should be estimated carefully before a final commitment to go ahead is made

2) Further study might not succeed in turning up feasible solutions that the industry could bring itself to accept without strenuous resistance.

3) Any new system would no doubt create its own problems and these might be worse.

On balance, my recommendation is that you should proceed with the study.

The total cost of the study might turn out to be less than the reduction in premiums for the citizens of Ontario in a single year.

While the study might fail in finding some improved legislative pattern that would be acceptable, this seems an unlikely outcome if the study is conducted with care and in a way that allows for a broad enough input on value judgment issues.

A new legislative pattern might produce problems as bad as existing ones. Adequate care and study of the effects of alternatives should minimize the probability of such an outcome. Furthermore, the present problems have been complained about for years; they will not go away unless positive step is taken.

5.2 What kind of solutions?

A fair question one might expect is 'what kind of solutions should a study be looking for?' The range of possibilities is wide and no doubt would be affected by each person's political and social philosphy. On the basis of my analysis it would appear that feasible solutions exist in proposals that would permit a minimum of continuing governmental involvement. It should be possible to devise some regulations which give the consumer a fair chance to make his own choices and which allow the industry to develop its own improvements and cost reductions in the marketing of insurance under competition. I recommend that this approach be adopted as an objective.

5.3 Scope

The analysis shows that there are many specific problems and separately identifiable proposals for solution.

One approach would be to narrow the future study to consideration of specific problems. In general, the problem with this approach is that the problems seem to be interrelated, and the proposals seem to cover more than one set of problems and they overlap. Thus, drawing the limits of study would not be as easy as one would like.

A particular problem one might want to isolate is redrafting of present legislation and regulations to do more effectively what they appear to be intended to do. I recommend this be done to solve problems for your administration, and clarify some technical issues for the industry. But it still would not touch most of the problems identified. It would do little for

the consumer. I do not recommend this approach be used alone.

The analysis shows in my opinion, that many problems are rooted in an industry structure that has changed little in this century. For this reason, the recommendation is that the study be broad, including a thorough analysis of the economic and organizational structure of the industry.

5.4 Scale

There are so many pieces to the problem and it is so complex, and the requirements for care and thoroughness are so great, that there seems little option but to consider a study of major proportion s.

5.5 Process and Place

If the study goes forward questions arise as to the appropriate process and forum for the study.

If the matter were simply a technical one, such as finding a 'best' method of price disclosure, then a suitable answer might be to assemble a committee of experts and set them to work. For some segments of the work such a method is appropriate. If the proper approach seems to be simply to try a few small independent changes, this method might work.

The matters to be looked into, however, are more than technical. They involve value judgments and the interests of many people. They are also part of a presently integrated system which is in some sort of balance. To change parts of the system could cause unnecessary upset in unexpected areas.

It is therefore necessary that possible solutions be evaluated not only in themselves for technical feasibility but for their interaction with other proposals and with the complex interests of the industry and public. This process requires that input come from many sources, so the form of the overall study should allow for an interactive process in the development of recommendations. The interaction should be between those running the study and those affected, industry segments and general public. This implies public hearings and submissions and perhaps even the use of draft proposals for public comment.

Because the consumer and the industry are unevenly balanced in terms of organized power, it would probably be helpful if the study were run by a body that had some visible standing as a broadly based arbiter in the public interest. A broadly representative Royal Commission or a Select Committee of the Legislature are possibilities that come to mind.